

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:LM:FS:HAR:POSTF-145169-01  
CJSantaniello

date:

SEP 10 2001

to:

Pat McGovern, Team Manager, LMSB Group 1471, Waterbury, Ct  
Attn: FrankDel Vecchio, Team Coordinator

from:

Associate Area Counsel, LMSB, Area 1 (LM:FS:HAR)

subject:

Large Case Advisory - [REDACTED]

This memorandum responds to your request for assistance dated August 27, 2001. This memorandum should not be cited as precedent.

In your memorandum, you request our legal advice regarding the taxpayer's claims for refund for [REDACTED] and [REDACTED] are timely. For the reasons set forth below, we believe that the facts demonstrate that the taxpayer made a timely claim for [REDACTED] and that there is a substantial likelihood that the taxpayer's claim for [REDACTED] is also timely.

**Issue**

Whether [REDACTED] filed timely claims for refund for [REDACTED] and [REDACTED]. U.I.L. Nos. 6511.09-00; 925.00-00

**Facts**

[REDACTED] ([REDACTED]) is a [REDACTED] company with advanced process technologies and [REDACTED] production facilities. It is the common parent of a consolidated group, and filed consolidated Forms 1120 for the taxable years [REDACTED] and [REDACTED]. During those years, it sold a portion of its products to customers outside the United States.

[REDACTED] organized [REDACTED] ([REDACTED]) under the laws of the U.S. Virgin Islands. On [REDACTED] [REDACTED] elected to be taxed as an FSC pursuant to section 922(a)(2). [REDACTED] operated and qualified as an FSC throughout the relevant time period.

Under an agreement between the parties, [REDACTED] paid [REDACTED] during the years [REDACTED] and [REDACTED] amounts intended to be the maximum commission allowable on foreign trading gross receipts (FTGR) derived from the sale of its export products. [REDACTED] calculated [REDACTED]'s profit each year to be the maximum profit allowable under the administrative pricing rules of section 925(a) and accompanying regulations.

On its timely [REDACTED] and [REDACTED] Forms 1120-FSC, [REDACTED] reported FSC commission income computed under the administrative pricing rules in section 925(a). On its [REDACTED] and [REDACTED] Forms 1120, [REDACTED] claimed correlative FSC commission expenses equal to the amounts reported as FSC commissions by [REDACTED].

By 30-day letter, the Service proposed adjustments to [REDACTED]'s income tax for [REDACTED] and [REDACTED]. These deficiencies are based, in part, on adjustments to [REDACTED]'s reported commission expenses. Following [REDACTED]'s protest, the administrative file was transmitted to the Appeals Division for settlement consideration. On [REDACTED], [REDACTED] and Appeals entered into a Form 870-D regarding [REDACTED] and [REDACTED], which reserved to [REDACTED] the right to file claims for refund with respect to certain items enumerated in the form.

While [REDACTED]'s taxable years [REDACTED] and [REDACTED] were pending in Appeals, [REDACTED] and [REDACTED] purportedly filed amended Forms 1120 and 1120-FSC, respectively, for their taxable years [REDACTED] and [REDACTED]. In the [REDACTED] and [REDACTED] amended Forms 1120-FSC, [REDACTED] reported additional taxes of \$[REDACTED] and \$[REDACTED], respectively, based on a redetermination of [REDACTED]'s commission income allowable under the administrative pricing rules in section 925(a). According to date stamps on the amended [REDACTED] Form 1120-FSC, it was received by the service center on [REDACTED].

Both the [REDACTED] and [REDACTED] amended Forms 1120-FSC were purportedly signed on [REDACTED]. Unlike the [REDACTED] return, the amended [REDACTED] Form 120-FSC does not contain a date stamp to conclusively establish when it was received by the service center. However, the taxpayer produced copies of three postal return receipts (PS Form 3811) bearing date stamps of [REDACTED], [REDACTED], and [REDACTED]. It is unknown precisely what was contained in the mailings received by the service center on those dates.

In its amended Forms 1120X for its taxable years [REDACTED] and [REDACTED], [REDACTED] claimed refunds of overpayments of \$[REDACTED] and \$[REDACTED], respectively. The decrease to its taxable income for those years is based, in part, on the correlative FSC commission

deductions of \$ [REDACTED] and \$ [REDACTED], respectively, appearing on the amended [REDACTED] and [REDACTED] Forms 1120X. These returns were allegedly mailed to the service center under separate cover letters dated [REDACTED]. It is unknown whether these letters were mailed separately or in the same envelope. As previously noted, the taxpayer produced copies of postal return receipts demonstrating three mailings to the service center on [REDACTED] (two) and [REDACTED].

On [REDACTED] and [REDACTED] and Appeals, respectively, executed a Form 872, extending [REDACTED] the statute of limitations for [REDACTED]'s taxable years [REDACTED] and [REDACTED] to December 31, [REDACTED]. It is undisputed that this form was a successor to previous valid Forms 872 and, therefore, timely itself.

By letter dated [REDACTED], the service center notified [REDACTED] that it could not process its amended [REDACTED] return because it was untimely. In that letter, the service center erroneously stated that (1) the type of tax was a "protective claim", as opposed to FSC corporate tax, and (2) the refund amount was \$ [REDACTED], as opposed to \$ [REDACTED]. It therefore appears that the service center was unaware of the Form 872, extending the statute of limitations for [REDACTED] and [REDACTED] to December 31, [REDACTED]. There is no indication that the service center ever responded to [REDACTED]'s claim.

#### Discussion

Section 6501(a) states the general rule on the period of limitation for assessment of tax, and requires the Service to assess tax due within three years after the return was filed. Section 6501(c) provides several exceptions to the general rule. Specifically, section 6501(c)(4) provides that the Service and taxpayers may enter into an agreement to extend the limitations period on assessment, provided the agreement is executed before the expiration of the period of assessment under section 6501(a), or as previously extended under section 6501(c)(4).

Section 6511(a) generally provides that claims for refund of an overpayment of any tax shall be filed by the taxpayer within three years from the time the return is filed or two years from the time the tax was paid, whichever of such periods expires the later. Section 6511(c) provides several exceptions to the general rule. In particular, section 6511(c)(1) provides that if the Service and a taxpayer have entered into an agreement to extend the period of limitations for assessment of tax pursuant to section 6501(c)(4),

the period for filing a claim for refund shall not expire before six months after the expiration of the extended period for assessment.

In 1984, Congress enacted the Foreign Sales Corporation (FSC) provisions (sections 921 through 927) for taxable years beginning after December 31, 1984 to cure perceived shortcomings in the Domestic Sales Corporation (DISC) provisions (sections 911 through 997). Deficit Reduction Act of 1984, Pub. L. 98-369, sec. 801(a), 98 Stat. 494, 990; S. Rept. 98-169 at 636. See Brown-Forman Corp. v. Commissioner, 94 T.C. 919 (1990), aff'd, 955 F.2d 1037 (6th Cir. 1992). Under the FSC system, a FSC is entitled to earn a sales commission on foreign trading gross receipts equal to the greater of the amounts computed under two general "administrative pricing" methods in section 925(a). The commission is then allowed as a deduction to the related supplier. A portion of the FSC commission (15/23rds in the case of a FSC owned by a corporate shareholder) is exempt from tax at the FSC level. The remaining 8/23rds, however, is taxed to the FSC at corporate rates. The after-tax commission, when distributed by the FSC as a dividend to its parent, is not subject to tax.

Foreign corporations that elect to be FSCs report income, expenses, and tax liabilities on Form 1120-FSC. Treas. Reg. § 1.921-1T(b)(3). These forms are due on or before the 15th day of the third month following the close of the taxable year. Section 6072(b). Under section 6501(a), the Service has three years from the filing of a Form 1120-FSC to assess tax relating to that return.

There exists no general statutory provision authorizing the filing of amended tax returns. Badaracco v. Commissioner, 464 U.S. 386 (1984). The Service, however, has recognized such returns for limited purposes as a matter of internal agency discretion. Koch v. Alexander, 561 F.2d 1115, 1117 (4th Cir. 1977); Treas. Reg. § 301.6402-3(a)(5) (a properly executed original or amended return constitutes a claim for refund).

In the case of FSCs and related suppliers, Treas. Reg. § 1.925-1T(e)(4) establishes the conditions in which such entities are permitted to file amended returns. Under that regulation, the FSC and related supplier ordinarily determine under section 925 the commission payable to the FSC for a transaction before the FSC files its return for the taxable year of the transaction. It further provides, however, that after the FSC files its return, it may redetermine its commission income only if the the taxable years

of the FSC and related supplier are still open under the statute of limitations for making claims for refund under section 6511 if they determine that a different transfer pricing method or grouping of transactions may be more beneficial.

In Union Carbide Corporation and Subsidiaries v. Commissioner, 110 T.C. 375 (1998), the Tax Court addressed the issue of whether a related supplier could claim additional commission expenses based on a redetermination of the FSC's commissions under Treas. Reg. § 1.925-1T(e)(4) where the supplier's statute of limitations for refund was open, but the FSC's statute was not. The taxpayer argued that Treas. Reg. § 1.925-1T(e)(4) allowed a redetermination so long as the refund statute of the entity seeking the refund (*i.e.*, the related supplier) was open. The taxpayer alternatively maintained that if the regulation required both the FSC's and the supplier's refund statutes to be open, that the regulation was invalid. The Tax Court rejected both arguments, holding that (1) Treas. Reg. § 1.925-1T(e)(4) allows a FSC and its related supplier to redetermine commissions only if the redetermination is made within the refund statute of both the FSC and the related supplier, and (2) that Treas. Reg. § 1.925-1T(e)(4) is valid.

The facts in Union Carbide are similar to those in the present situation. In that case, the taxpayer's taxable years 1987, 1988, and 1989 were before the court. While the case was pending, the taxpayer filed amended Forms 1120-FSC for those years, reporting additional FSC commission income and the resulting additional income tax due. These amounts corresponded precisely to the amounts of additional commission expenses claimed by the taxpayer in its amendments to the petition filed in that case. When the taxpayer amended its petition, the statute of limitations for its 1987, 1988, and 1989 Forms 1120 remained open, but the limitations period for the Service to assess deficiencies under section 6501(a) and for the FSC to file claims for refund for those years under section 6511 had already expired.

In this case, the limitations period for [REDACTED]'s and [REDACTED]'s taxable years [REDACTED] and [REDACTED] expired on December 31, [REDACTED] pursuant to a timely executed Form 872. Accordingly, the sole question is whether [REDACTED] and FSC filed the amended [REDACTED] and [REDACTED] Forms 1120 and 1120-FSC before that date. This is a factual question for which the taxpayers bear the burden of proof.

Based on the evidence as a whole, it appears that [REDACTED] and [REDACTED] filed timely [REDACTED] and [REDACTED] claims before the statute of limitations expired on December 31, [REDACTED]. As previously noted, the amended [REDACTED] Form 1120-FSC bears an IRS date stamp reflecting a receipt date of [REDACTED]. Thus, there is no question regarding the timeliness of this claim. Similarly, in its letter dated [REDACTED], the service center acknowledged that its received [REDACTED]'s [REDACTED] Form 1120X on [REDACTED]. Accordingly, the inquiry narrows to the timeliness of the amended [REDACTED] Form 1120-FSC and the [REDACTED] Form 1120X.

Unlike its [REDACTED] counterpart, the amended [REDACTED] Form 1120-FSC does not bear an IRS date stamp. Additionally, the taxpayer has not produced a letter from the service center as it did regarding the [REDACTED] claim. The taxpayer did, however, produce three postal return receipts, two bearing receipt dates of [REDACTED] and one with a [REDACTED] receipt date. Although there is no conclusive proof that any of these receipts relates to the amended [REDACTED] Form 1120-FSC, as opposed to the amended [REDACTED] Form 1120-FSC or the [REDACTED] and [REDACTED] Forms 1120X, you may accept credible oral testimony to resolve this issue. Additionally, transcripts of account may also reflect the filing of an amended [REDACTED] Form 1120-FSC from [REDACTED].

Similarly, [REDACTED]'s [REDACTED] Form 1120X does not bear a date stamp. The [REDACTED] and [REDACTED] Forms 1120X, signed on [REDACTED] and [REDACTED], respectively, were filed under separate cover letters dated [REDACTED]. As previously noted, it is unknown whether these returns were mailed in the same envelope. Again credibly oral testimony and/or a transcript of account may provide the answers necessary to resolve this question of fact.

Based on the signature dates of the four returns and the dates appearing on the postal return receipts, the following scenario is entirely possible: Although [REDACTED]'s [REDACTED] and [REDACTED] Forms 1120X were signed on different dates ([REDACTED] and [REDACTED]), they were filed under separate cover letters bearing the same [REDACTED] mailing date. If these returns were mailed separately on the signature dates, they could correspond to the postal return receipts dated [REDACTED] (5-day mail) and [REDACTED] (7-day mail), respectively.<sup>1/</sup> Regarding the two amended Forms 1120-FSC, both signed on [REDACTED], they could have been

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<sup>1/</sup> These mailings occurred during the last weeks before Christmas.

mailed on that date in the same envelope, and received by the service center on [REDACTED], the date appearing on the third postal return receipt. Regardless of the possible combinations, we recommend that you ask the taxpayers the necessary questions to resolve this uncertainty before allowing [REDACTED]'s [REDACTED] refund claim.

We are simultaneously submitting this memorandum to the National Office for post-review and any guidance they may deem appropriate. Consequently, you should not take any action based on the advice contained herein during the 10-day review period. We will inform you of any modification or suggestions, and, if necessary, we will send you a supplemental memorandum incorporating any such recommendation.

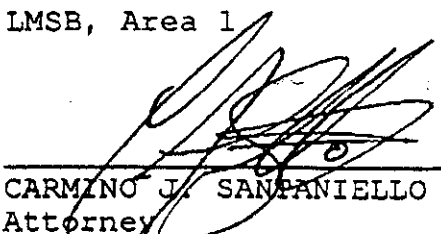
This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

Since there is no further action required by this office, we will close our file in this matter ten days from the issuance of this memorandum or upon our receipt of written advice from the National Office, whichever occurs later.

Please call Carmino J. Santaniello at (860) 290-4075 if you have any questions or require further assistance.

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By:

  
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